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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, MAY 6, 1985 VOLUME XXII, NUMBER 18

Corporate Profits Falter . . .

Reflecting the slowing pace of economic activity, the performance of corporate profits is not what it was earlier in this expansion. The first quarter's pretax earnings were well short of year-ago levels at most companies. But while these lackluster results are surely disappointing to corporate treasurers and shareholders, such performance is not unusual at this stage of the business cycle. The recovery is showing signs of normal aging—as productivity slows and operating costs rise—indicating that the strongest incomes gains are behind us.

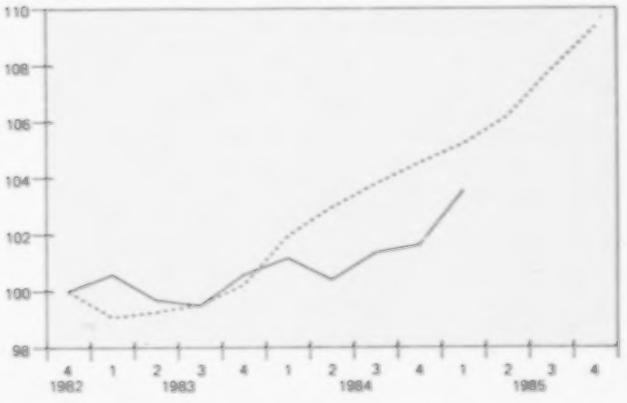
But that's not all. Corporate profits during the last few quarters have been undermined by the over-valued dollar, which was a factor in their $15 billion fall to an estimated $228 billion from $243 billion a year ago. While domestic demand remains healthy, output of the nation's factories has slowed, as production has shifted abroad. American companies have to contend with the ever rising tide of imports, which now amount to more than ten percent of our GNP, adjusted for inflation, up from about 7½ percent just two years ago. By the same token, the strong dollar has hurt the ability of our exporters—from farmers to capital goods manufacturers—to compete in world markets. To make matters worse, the rising dollar has depressed foreign earnings of U.S. multinational companies, when they are translated into dollars.

. . . Reflecting The Business Slowdown . . .

Not only has the swelling tide of imports taken away market share here in the United States, it has also prevented U.S. companies from beefing up profit margins by raising prices—as they have done during past expansions. In fact, many have been forced to shave prices to remain competitive with their overseas rivals. Thus, with all other avenues closed, cost containment remains the primary controllable variable by which U.S. companies can improve the bottom line.

Thus far in the recovery, this approach has been successful. For example, the rise in unit labor costs—which represent two-thirds of total business costs—has been much slower than the average of the five previous postwar recoveries that lasted this long (see chart). It has been accomplished mainly by businessmen keeping a tight rein on wages and salaries for unionized as well as for nonunionized workers. Although productivity gains in this recovery have been somewhat weaker than normal, efficiency in the work place has nevertheless improved, as companies modernized production facilities, closed inefficient plants thus lowering break-even points.

UNIT LABOR COSTS FOR PRIVATE BUSINESS SECTOR
CURRENT RECOVERY (LINE) VS. AVG. OF 5 PRIOR RECOVERIES (DOT)
(TROUGH=100)



. . . And The Strong Dollar . . .

In the first quarter, unit labor costs suffered a setback. A steeper rise in per-hour compensation abetted by a 1.9 percent month-over-month decline in business productivity pushed unit labor costs up at a whopping 7.8 percent annual rate from 1984's fourth quarter. Durable goods manufacturers were more successful in controlling costs as productivity gains outstripped increases in worker compensation, keeping unit labor costs three percent below their high point in late 1982.

While the first quarter rise in unit labor costs was the sharpest in almost three years, it does not necessarily portend the beginning of an upward spiral in the rate of inflation. True, as capacity becomes more fully utilized and companies hire less experienced workers, the pressures on costs could intensify. However, the earlier record burst in capital spending on durable equipment should

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continue to provide a sizable boost to productivity. Additionally, labor settlements are not likely to depart significantly from the recent trend of modest wage increases.

. . . But Costs Stay In Check

While labor settlements in the first quarter of 1985 were somewhat more generous than last year's, they were still substantially less than the gains labor won the last time the same parties bargained—generally two to three years ago. One out of five of those workers who bargained had to settle for no increase in the first contract year while some others even gave pay concessions. The second quarter's settlements are likely to be less generous because the bargaining muscle of the major labor groups involved—apparel, electrical products and construction—has been weakened by slowing economic growth, the strong dollar or both.

While it is book profits that receive the most attention, the improved quality of earnings may provide some solace to company treasurers. A look beneath the surface suggests that U.S. companies may not be faring as poorly as the top-line numbers suggest. Profits from current production—a more reliable gauge of profitability in today's circumstances because they are adjusted to reflect capital depreciation more accurately and they eliminate the effects of inflation on inventories—have been growing vigorously. These are believed to have risen to $298 billion last quarter, up 7½ percent from a

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	5/1/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	180.756	+ 8.484	+10.455
Loans to Depository Inst.	1.272	+ .154	+ .243
Float	.121	– .487	– .445
Total Reserve Bank Credit	195.066	+ 8.889	+13.313
Treasury Deposits with Federal Reserve Banks	16.463	+10.447	+ .996
Currency in Circulation	180.477	– .339	+ 9.981
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	115.532	– 1.154	+ .163
	4/24/85		
Member Bank Reserves:			
Total Reserves Held	41.904	+ 1.099	+ 3.935
Excess (Deficiency)	.897	+ .340	+ .329
Net Free Reserves	.505	+ .428	+ 1.125

		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1	(4/22/85)	576.2	+ 8.8‡	+ 6.7‡
M2	(March '85)	2,429.3	+ 9.8	+ 9.0
M3	(March '85)	3,055.4	+ 8.1	+ 10.5
Domestic Nonfinancial Debt (4th Q'84)		5,970.8	+ 14.4	+ 13.6

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 5/3/85			
‡U.S. Treasury Bills	7.65%	7.90%	8.10%
* Federal Agencies	7.85	8.45	9.05
* Project Notes–Taxfree (46% Taxable Equivalent)	9.72	9.72	9.72
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.21	8.42	9.13

‡Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.15%	Jun.	8.10%
15- 29 days	8.15	Jul.	8.10
30- 59 days	8.15	Aug.	8.10
60- 89 days	8.15	Sep.	8.15
90-179 days	8.20	Oct.	8.15
180-239 days	8.20	Nov.	8.15
240-270 days	8.25		

‡Industrial Paper–Prime			
30- 89 days	8.10%	†Federal Funds Effective Rate	8.35%
90-120 days	8.10		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'85	$ 3,820	$ 3,759	$ 3,553
Gross National Product (1972 Dollars)*	1st Q'85	$ 1,668	$ 1,662	$ 1,611
Percent Change, Annual Rate	1st Q'85	1.3	4.3	10.1
Change in Consumer Prices*	Mar '85	6.0%	3.6%	3.6%
Change in Producer Prices*	Mar '85	2.4%	– 1.2%	6.0%
Civilian Employment (Thousands of Persons)†	Apr '85n	106,945	107,119	104,402
Unemployment as % of Civilian Labor Force†	Apr '85n	7.3%	7.3%	7.8%
Personal Income*	Mar '85	$ 3,156	$ 3,140	$ 2,941
Leading Indicators Composite Index (1967=100)†	Mar '85n	167.1	167.5	167.2
Industrial Production Index (1967=100) †	Mar '85	165.4	164.9	160.8
Net Change in Consumer Installment Credit †	Feb '85	$ 10.37	$ 7.22	$ 6.19
U.S. Merchandise Trade Balance †	Mar '85n	–$ 11.05	–$ 11.45	–$ 10.27
Plant and Equipment Expenditures*	2nd Q'85	$388.86(a)	$380.05(a)	$348.34
Private Housing Starts (Thousands of Units)*	Mar '85	1,895	1,631	1,700
New Construction Expenditures*	Mar '85n	$ 324.2	$ 323.8r	$ 309.7
Total Business Inventories †	Feb '85	$ 576.9	$ 574.8	$ 531.9
Total Business Sales †	Feb '85	$ 419.2	$ 418.3	$ 402.4r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

year ago; they have nearly doubled since the start of the current recovery. During the first nine quarters of five earlier postwar expansions, an average gain of only 55 percent was recorded. Due to low rates of inflation and more careful stock monitoring, inventory profits now comprise the smallest proportion of pretax profits in almost 20 years. After reaching their most recent high of over 22 percent of profits in early 1980, inventory profits now represent less than one percent.

Some industries fared well during the first quarter. For example, the telecommunications industry posted healthy sales gains. Combined with reduced labor costs and the introduction of other cost-saving technology, the industry was able to post good-sized increases. Similarly, health care, lodging and publishing industries registered advances.

On the other hand, most manufacturing firms continued to suffer. Overcapacity and stagnant prices plague the chemical industry as the strength of the dollar has cut into export markets and caused a sharp upturn in imports. The big oil companies saw profits sag as demand slowed in the U.S. and the strong dollar kept prices high for holders of foreign currencies. Finally, the steel industry is still awaiting a return to profitability, despite dramatically lower break-even points and reduced capacity. Cheap imports are still displacing a large part of domestic production, postponing the recovery in this industry well into the future. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (4/17/85)	155,608	– 439	+13,956
New York City (4/24/85)	33,441	+ 460	+ 4,643
Commercial Paper (4/24/85)	254,531	+ 2,534	+45,050

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/17/85)	254,780	+ 412	+ 17,985
New York City (4/24/85)	61,240	– 686	– 369

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/17/85)	671,011	+ 6,719	+ 67,703
New York City (4/24/85)	144,752	– 1,792	+ 9,912

Financial Markets

	Friday 5/3/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.90%	– .14	– 2.16
180-Day Bills†	8.30	– .17	– 2.40
Longest Bills†	8.70	– .20	– 2.45
Recent Issues:			
9¾s 4/30/87	9.70	– .19	
11¼s 3/31/89	10.45	– .19	
11¼s 2/15/96	11.15	– .19	
11¼s 2/15/15	11.30	– .12	
Municipals:			
Bond Buyer–20 Bond Index* (5/2/85)	9.37%	– .02	– .62
Blue List Total ($ Million)	$1,587	+ $ 45	+ $ 34
30-Day Visible Supply ($ Million)	$3,838	– $492	+ $1,308
Total	$5,425	– $447	+ $1,342
Corporates:			
Moody's Aa Composite (5/2/85)	12.61%	+ .01	– 1.15
30-Day Visible Supply ($ Million)	$1,135	+ $775	– $ 870
Stocks:			
Dow-Jones Averages:			
Industrials	1,247.24	– 27.94	+ 81.93
Transportation	584.48	– 1.77	+ 76.87
Utilities	154.95	+ .20	+ 28.46
65 Stocks	507.12	– 6.86	+ 51.15
Standard and Poor's 500 Stocks	180.08	– 2.10	+ 20.97
N.Y.S.E. Composite Index	104.18	– 1.34	+ 12.43
N.Y.S.E. Avg. Daily Vol. for Week (000's)	101,046	+ 4,132	+ 4,754

* 46% Taxable equivalent 17.35%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/3/85	Week Ago
Overnight	8.13%	8.06%
1 month	8.31	8.31
3 month	8.50	8.56
6 month	8.80	8.94
1 year	9.31	9.63
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	11.25%	11.30%
Long Term (7 to 15 yrs.)	11.40	11.55

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/3/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01559	64.1250
Canada	.7263	1.3769
Denmark	.08734	11.4500
France	.1029	9.7150
Germany	.3136	3.1890
Italy	.0004931	2028.00
Japan	.003949	253.25
Mexico	.004049	247.00
Netherlands	.2777	3.6005
Switzerland	.3740	2.6735
U.K.	1.2125	.8247

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